Alternative assets in 401(k) plans

MFA principles

Introduction

- We support public policy that ensures investors in 401(k) and similar professionally managed retirement plans have greater opportunities to participate in alternative investments.
- ERISA does not dictate what investments are permitted to be made by any employee benefit plan. It authorizes the fiduciaries of the plan, not the government, to make that determination, acting prudently and in the best interests of plan participants. Most fiduciaries hire professional financial and legal advisors to help them select investment options.
- Fiduciaries of defined benefit (pension) plans have long included allocations to alternative investment funds and strategies as part of their overall investment portfolios for any number of reasons, which can include enhancing returns, reducing portfolio volatility, or providing diversification to fund their long-term obligations.
- Participants in defined contribution plans, such as 401(k) plans, have not had the same opportunities to benefit from alternative strategies in structures appropriate to them. Traditional balanced portfolios that include only publicly traded stocks and bonds no longer represent the broader economy and investment universe.
- While plan sponsors may recognize the value of alternative investment strategies, some may be discouraged by regulations that may increase their legal risks and add substantial operational complexity.

As policymakers continue to identify ways to provide the clarity and safeguards needed for plan sponsors to offer appropriately broad and flexible investment options that allow retirement savers to best meet their investment objectives, we offer the following principles.

Principles

1. Plan beneficiaries are best served with a flexible and wide range of investment options, including exposure to alternative investment strategies through target date or other asset allocation funds, to help meet participants' retirement savings needs.

- Savers at all stages of their life and career should be entitled to participate in alternative investment strategies, with appropriate safeguards and oversight by plan fiduciaries.
- Plan sponsors should be supported by regulatory policy when considering plan investment options that include alternative strategies.

2. Regulatory clarification on alternative investment strategies should be investment strategy neutral.

- Alternative investment strategies can be appropriate investments within 401(k) investments, such as target date or other asset allocation funds. These strategies help support the investment objectives of participants with longer investment horizons and plan sponsors may wish to include them to deliver better retirement outcomes
- Regulatory clarification on alternatives should be strategy neutral and process-based to best support the ability of plan sponsors to implement a plan menu with a range of strategies appropriate to their participants — not requiring plan sponsors to select or exclude specific asset classes.

3. **Professional investment managers and fiduciaries provide important risk management.**

- Alternative investments make the most sense for 401(k) investors when a sophisticated investment professional is evaluating the investment, such as a professionally managed account, an asset class or strategy within a larger diversified fund, or a target date or asset allocation fund managed by a registered investment adviser.
- Plan sponsors are subject to ERISA's fiduciary duties in selecting, monitoring, and overseeing the investment fund options made available in the plan, and participants would continue to receive fund educational material that clearly explains the strategies and risks of each fund offered.

4. **Fees should be evaluated based on the nature and breadth of the investment services being provided and the character of each plan and its participants.**

- ERISA does not require that a plan pay the lowest fee possible.
- Policymakers should continue to emphasize and reinforce that while fees and expenses must be reasonable, they must always be evaluated in light of the actual services being provided and the returns to investors after fees. Reasonableness should be determined based on the marketplace for such services.
- The ability of an asset allocation fund to meet its long-term investment objectives net of fees should be one of the criteria taken into consideration in assessing investment strategies for inclusion in the portfolio.

5. **Overzealous litigation must be addressed.**

- Fiduciaries of 401(k) plans have been subject to numerous class action lawsuits, which seek to leverage ERISA's rules to make defending cases expensive. Such actions provide limited benefit to the participants but create legal risk for plan sponsors.
- The risk of litigation understandably makes plan sponsors reluctant to embrace innovation in investment design and pushes plan sponsors to focus solely on fees or commoditized investments that have been commonly used by 401(k) plans, even at the cost of better long-term returns and other benefits.
- Contrary to many of the claims in these cases, ERISA does not require that fiduciaries make the "best" choice with hindsight; ERISA appropriately requires fiduciaries to use a prudent process to pick investments and ensure fees are reasonable.
- Policy makers should prioritize actions that may curb ERISA litigation that constrains fiduciaries' ability to apply their best judgment in offering investment opportunities to plan participants.